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Citations.

Opinions Below.

In re The Chicago, Rock Island and Pacific Railway Company (D. Ill. E. D., May 14, 1945) (unreported).

In re The Chicago, Rock Island and Pacific Railway Company (C. C. A. 7th, 1946) (unreported).

Supreme Court of the United States

OCTOBER TERM, 1946

THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,
Petitioner,

against

JOSEPH B. FLEMING and AARON COLNON, as Trustees of The Chicago, Rock Island and Pacific Railway Company, et al.,
Respondents.

No. 410.

BRIEF OF RESPONDENTS:

1. METROPOLITAN LIFE INSURANCE COMPANY, AS REMAINING MEMBER OF THE FIRST AND REFUNDING GROUP,
2. TRUSTEES UNDER THE FIRST AND REFUNDING MORTGAGE,
3. TRUSTEE IN RESPECT OF THE SECURED 4½% BONDS, SERIES A,
4. PROTECTIVE COMMITTEE FOR THE GENERAL MORTGAGE BONDS,
5. TRUSTEES UNDER THE GENERAL MORTGAGE,
6. PROTECTIVE COMMITTEE FOR THE ROCK ISLAND, ARKANSAS AND LOUISIANA RAILROAD COMPANY FIRST MORTGAGE 4½% BONDS,
7. PROTECTIVE COMMITTEE FOR CHOCTAW, OKLAHOMA AND GULF RAILROAD COMPANY CONSOLIDATED MORTGAGE 5% BONDS AND CHOCTAW AND MEMPHIS RAILROAD COMPANY FIRST MORTGAGE 5% BONDS,

IN OPPOSITION TO DEBTOR'S PETITION FOR WRIT OF CERTIORARI.

Statement.

The Debtor has applied to this Court for a writ of certiorari to review the order and decree of the United States Circuit Court of Appeals for the Seventh Circuit,

dated May 23, 1946, affirming a United States District Court order dated June 15, 1945, approving a modified Plan of Reorganization certified by the Interstate Commerce Commission to the District Court on May 1, 1944.

We respectfully submit that the Debtor's petition for certiorari should be denied:

1. Because the Debtor has no standing to apply for certiorari, since the questions it seeks to present concern only the creditors and do not affect the Debtor; and

2. Because the questions sought to be presented are factual issues of valuation, and no question of law warranting review by this Court is involved.

Argument.

1. The Debtor has no standing to apply for certiorari, since the questions it seeks to present concern only the creditors and do not affect the Debtor.

The Debtor did not contend below, and does not contend here, that there is any equity in the Debtor's property for the Debtor or its stockholders. The Circuit Court of Appeals held in its opinion (R., p. 351) that claims of the secured creditors of the Rock Island are unsatisfied under the modified Plan to the extent of about $54,000,000 if the new no par value common stock is taken at $100 a share, and to the extent of about $106,000,000 if the new no par value common stock is taken at $50 a share, which is what it has been adjudicated to be worth in this proceeding by the Interstate Commerce Commission and the United States District Court. The Debtor does not dispute that there is this enormous deficiency which would have to be overcome before there could be any recognition from the mortgaged assets for the large amount of unsecured claims, or that

an additional enormous deficiency in satisfying the unsecured claims would have to be overcome before there could be any recognition for the Debtor or its stockholders.

Therefore, as the Court said below (R., p. 347):

> "The debtor seeks nothing for itself. It is in the anomalous but commendable position of arguing for others. The debtor, appropriately, does not question the valuations of the Commission."

We submit that in this situation the Debtor has no standing to seek review in this Court on the questions it seeks to present, since they would not affect the Debtor no matter how they were decided.

2. The questions sought to be presented are factual issues of valuation, and no question of law warranting review by this Court is involved.

Of all the many points which had to be determined by the Commission and the District Court or agreed to by the parties in arriving at the modified reorganization Plan for this large and complicated railroad system, the Debtor picks out two which it seeks to present to this Court. The two questions relate to the allocation of cash and additional new First Mortgage Bonds in the modified Plan approved by the Commission and by the District Court after the first Plan was sent back to the Commission by the District Court in 1943. The secured creditors who share in the cash and additional First Mortgage Bonds agreed to the allocation thereof or did not object to it. Yet the Debtor seeks to come before this Court and argue points on behalf of creditors who raise no such objections and would have no standing to raise them.

The facts with respect to the allocation of the cash and additional First Mortgage Bonds are these:

The Rock Island reorganization proceedings commenced in June, 1933. The Commission first certified a Plan to the District Court in July, 1941. The District Court held hearings on the Plan in October, 1941. At that time the *Milwaukee* case and the *Western Pacific* case were on their way to this Court. Those cases, settling fundamental legal questions regarding Section 77 reorganizations, were decided by this Court in March, 1943. *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523 (1943); *Ecker* v. *Western Pacific Railroad Corp.*, 318 U. S. 448 (1943).

While those appeals were pending, the District Court took no action in the *Rock Island* case. After this Court's decisions on those appeals, the District Court, in June, 1943, rendered its opinion approving the Plan first certified to it with only two exceptions (R., p. 297). When the District Court sent the Plan back to the Commission for correction on these two exceptions, it also suggested that the Commission distribute among creditors the cash which was available for distribution and make other appropriate adjustments in the allocations of new securities (R., pp. 299-300).

The Commission held a hearing in September, 1943, and then modified the Plan by distributing among creditors approximately $38,000,000 in cash, which was all that would be available for distribution at December 31, 1943 in accordance with testimony of the Trustees of the Rock Island Estate. The Commission also distributed among creditors $12,409,600 of additional new First Mortgage Bonds which it found to be available primarily because the Estate would not need the $11,000,000 of new First Mortgage Bonds

which had been reserved for sale for cash. The total allocations of cash and new securities under the modified Plan appear at page 259 of the record.

In the lower courts, the Debtor argued that the creditors were "paid in full" by the allotment of securities contained in the first Plan certified by the Commission to the District Court in July, 1941, and that any improved treatment of the secured creditors in the modified Plan as compared with the first Plan represented more than 100% satisfaction of their claims. The obvious fallacy is that the creditors' claims were not satisfied under the first Plan. Nothing more need be shown in support of this than the finding of the Court below that even with the improved treatment in the second Plan $106,000,000 of the claims of secured creditors remained unsatisfied (R., p. 351).

The Debtor complained below, and complains here, of the method used by the Commission in distributing the cash and additional new First Mortgage Bonds among the creditors under the modified Plan. This we submit is a factual valuation question and presents no question of law. The $12,409,600 additional new First Mortgage Bonds were allocated among creditors by the same method which the Commission had found fair and equitable for distribution, on the basis of comparative earnings, of new First Mortgage Bonds allocated under the Plan first certified, and the District Court approved the allocation (R., pp. 234, 304). So far as the distribution of the $38,000,000 of cash is concerned, the distribution was based on the allocations of the respective classes of new securities under the Plan. The Commission said as to that distribution (R., pp. 234-6):

> "*Method of distribution of surplus cash.*—The first and refunding group proposes that the surplus cash be distributed among the creditors on the basis of the relative earnings of the various mortgaged

properties as determined by the allocation of new securities approved in the present plan. This proposal contemplates the distribution to those who will receive the new securities of cash amounting to 8 years' interest on the new first-mortgage bonds, 4 years' interest on the new income bonds, 2 years' dividends on the new preferred stock, and a dividend of $2.50 per share on the new common stock. The total accrued unpaid interest on the Choctaw & Memphis bonds also would be paid in cash. This method of distribution, the group contends, is fair and equitable since it gives effect to the earnings of the debtor and its cash position during the period when the cash was produced.

"The group first reviewed the earnings record of the debtor during this proceeding to see approximately how distributions would have been made under the plan on the reorganization securities had they been issued. The years prior to 1936 were dropped from consideration on the theory that the proceeding commenced halfway through 1933, and 1935 was a deficit year. In the 8 years from 1936 to 1943, inclusive, it appeared from the debtor's income available for interest that all accrued unpaid interest on the Choctaw & Memphis bonds had been earned, likewise all fixed interest on the new first-mortgage bonds and on the new Reconstruction Finance Corporation note, 4 years' contingent interest on the new income bonds and Reconstruction Finance Corporation note, and dividends on the new preferred stock for the 3 years from 1941 to 1943, inclusive, with an excess over such dividends in those years. Distribution of the surplus cash on that basis, however, would not have permitted any distribution in respect of the new common stock. Another factor considered by the group was that while earnings in each of the 6 years, 1936-41, inclusive, would have taken care of 6 years' fixed interest, 2 years' contingent interest, and preferred-stock dividends for

1 year, the cash on hand on December 31, 1941, would not have permitted any distribution of any dividend on the new preferred stock. Cash on hand as of December 31, 1941, was $16,848,913, while the requirements through contingent interest, and without any new preferred-stock dividend for 1941, were approximately $16,500,000. The deduction of $16,500,000 from the surplus cash of $38,000,000 left $21,500,000, and that amount would permit the distribution of 2 years' dividends on the new preferred stock, and a dividend of $2.50 per share on the new common stock. It was for these reasons that the distributions in the amounts proposed by the group were adopted.

* * * * * *

"The method of cash distribution proposed by the first and refunding group gives recognition to the relative values of the claims of the respective classes of creditors and reflects the debtor's earning power at different levels of earnings. We also believe that we are warranted in giving considerable weight to the circumstances that all active representatives of the secured creditors have found it acceptable. In our opinion, the first and refunding group's proposed method of distribution is fair and equitable."

The District Court approved the Commission's findings (R., pp. 302, 304, 308). These factual findings, sustained by the Circuit Court of Appeals, would certainly seem to be conclusive on the Debtor.

No secured creditors have objected to the allocation of the cash and additional First Mortgage Bonds which was approved by the Commission and the District Court. Certainly the Debtor has never been able to show and cannot show that the allocation in any way adversely affects the Debtor.

In its petition in this Court, the only contention the Debtor makes is that the allocation is different from what it would have been under what the Debtor calls the "Denver & Rio Grande Doctrine," and under what it calls the "Milwaukee Doctrine." The argument seems to us to have no substance. Valuations necessarily differ in every railroad reorganization case. Different methods of allocation of the new securities and cash have necessarily been followed in each of the railroad reorganization cases which has been approved by the Courts, since the allocations have been governed by the facts of each particular case. Decisions of this Court approving the method of allocation of cash and new securities in a particular reorganization case as fair and equitable do not establish a "doctrine" that a particular method of allocation is the only one that can be used under the facts of any case and be considered fair and equitable. Different methods were used in the *Denver & Rio Grande* case and the *Milwaukee* case; yet both methods were held by this Court to be fair and equitable. *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 66 S. Ct. 1282 (1946); *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523 (1943).

Furthermore, what the Debtor calls the "Denver & Rio Grande Doctrine" is, we submit, a misconstruction of this Court's opinion in that case. We first emphasize that there was in fact no distribution of cash in the Denver & Rio Grande modified plan, and that the total capitalization was not materially changed in the second Denver & Rio Grande plan as compared with the first. Thus, when the Debtor is referring to the "Denver & Rio Grande Doctrine" it is not referring to any allocation which actually was made in that case, but is merely advancing a hypothetical argument based solely on its interpretation of this

Court's opinion in that case. Essentially the argument is that the Commission, having once fixed an effective date of January 1, 1942, could not really change the effective date when the plan came back to it for modification; and that if in form the Commission then purported to change the effective date, the terms of the plan must nevertheless be adjusted to accord with the original effective date. As a result, the Debtor argues that when the Commission changed the effective date of the Rock Island Plan from January 1, 1942 to January 1, 1944, the Commission should have allocated a large part of the earnings in the intervening two years to junior and unsecured creditors, even though the claims of senior creditors were far from satisfied under the first Plan and are far from satisfied under the modified plan. Certainly that is an artificial and unsound theory which cannot be supported by anything this Court said in the *Denver & Rio Grande* case. The Commission effectually disposed of this type of contention (R., pp. 234-6), and its action has been approved by the Courts below. Furthermore, as shown above, the distribution of $38,000,000 of cash in the *Rock Island* case did not constitute merely the distribution of earnings for the years 1942 and 1943 but involved a consideration of the earnings record of the Rock Island from the beginning of the reorganization.

Next the Debtor argues that the distribution of cash and new securities in the present case by the Commission and the District Court is inconsistent with what it refers to as the "Milwaukee Doctrine." The Debtor contends that the "Milwaukee Doctrine" is that if the effective date of a plan is moved forward for a period of years, the only change which should be made in the first plan, with respect to the distribution of any cash earned in the intervening period, is to give each bondholder, senior or junior, interest for those years on his old bonds. Such a method of distribution,

ignoring the relative values and earnings of the respective mortgaged properties, would be plainly unjust.

In fact, the distribution of cash made in the Milwaukee modified plan was not made in accordance with what the Debtor calls the "Milwaukee Doctrine." In the *Milwaukee* case, the effective date was moved forward from January 1, 1939 to January 1, 1944. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company Reorganization,* 254 I. C. C. 707, 712, 722 (December, 1943). The modified Milwaukee plan did not simply provide for payment of the interest accruing on the old bonds during this five-year period. On one large senior issue which was to receive the bulk of the cash distribution, interest was to be paid *from July 1, 1935* to January 1, 1944, the amount for the period between July 1, 1935 and December 31, 1938 being limited to that earned by the mortgaged properties as shown by an earnings and expense formula (254 I. C. C., at p. 712). No interest whatever was to be paid on the $182,000,000 issue of Milwaukee Convertible Adjustment Bonds (254 I. C. C., at p. 739). In other words, no such fixed formula as the Debtor contends for was applied in the *Milwaukee* case with respect to the distribution of cash. The proposed cash distribution was generally agreed to by the interests who were to share in it, and was approved by the Commission and the District Court as fair and equitable in the light of the facts in the *Milwaukee* case.

The mortgage structure and the earnings situation of the Milwaukee and the Rock Island systems were entirely different. The Milwaukee had a relatively simple mortgage structure as compared with the Rock Island, with its complicated overlapping liens and pledged bond issues. With a simple mortgage structure where there are first, second and third mortgages on the same property, it may be equitable to distribute cash in a plan by paying some

interest on the old senior bonds, because cash would thereby be distributed in accordance with the priority of liens. But in the *Rock Island* case, the mortgages are not senior and junior liens on the same properties. For example, the First and Refunding Mortgage, securing the largest amount of bonds, is a first lien on some properties and a second lien on others, and has pledged for it large blocks of other issues of Rock Island bonds in turn secured by first liens or second liens on other Rock Island properties. Distributing cash as interest on the old bonds in such a situation would give no assurance whatever that the allocation was in accordance with the relative earnings or values of the respective mortgaged properties.

No secured Rock Island creditor would have thought it fair, nor could the Commission or the Courts below ever have found it fair and equitable, to distribute a substantial amount of cash among the various secured creditors based merely on the interest accruing on their old bonds without regard to the value or earnings of the properties securing those bonds. As pointed out above, no such inflexible method was used in the distribution in the *Milwaukee* case.

With respect to the distribution of the additional Rock Island First Mortgage Bonds, the *Milwaukee* case is directly contrary to the Debtor's contentions. In the Milwaukee modified plan, additional new securities were allocated in the same proportions in which securities of the same issue were allocated under the first plan (254 I. C. C., at p. 723). That was exactly what was done in the *Rock Island* case in connection with the distribution of the additional new First Mortgage Bonds.

In the *Rock Island* case, the allocation of the cash and additional First Mortgage Bonds was not handled in an offhand or arbitrary fashion. It was largely agreed to, and in no instance objected to, by the secured creditors.

The Commission found that the distribution gave recognition to the relative values of the claims of the respective classes of creditors. The District Court approved the finding, and it has been sustained by the Circuit Court of Appeals.

The Debtor has shown nothing unfair in the method of distribution. It is not in any way affected by the method of distribution. We submit that it is plain that the questions which the Debtor seeks to present to this Court are not questions of law but are factual questions of valuation which are wholly without merit.

Conclusion.

The Debtor contends that its own petition for a writ of certiorari is moot because the District Court has now refused to confirm the Rock Island Plan and has referred it back to the Commission for further proceedings. But the Debtor contends that its petition will cease to be moot in case the appeal taken from that order of the District Court results in reversal. The Debtor therefore asks for an indefinite postponement of decision by this Court on its petition for a writ of certiorari.

With this reasoning and request we must disagree. The decision of the Circuit Court of Appeals, for review of which the Debtor's application is made, affirms an order of the District Court holding the relative allocations of new securities and cash among the various classes of creditors to be fair and equitable. The recent order of the District Court sending the Plan back to the Commission relates only to the rights of one class of creditors, the unsecured Convertible Bondholders, which did not vote to accept the Plan. Whether the recent order of the District Court is reversed

and the Plan then stands as confirmed, or whether the recent order of the District Court is upheld and the Commission is required to adjust the allocations to the unsecured Convertible Bondholders, the decision of the Circuit Court of Appeals sought to be reviewed here established the rights of the various classes of creditors. In the interests of prompt reorganization, the finality of that decision should be promptly settled. If the Debtor's application should stand undecided in this Court, it would simply be a means of furnishing the Debtor with further delay.

We should add that the recent decision of the District Court refusing to confirm the Plan and referring it back to the Commission was not based on any unanticipated developments in the *Rock Island* case justifying the negative vote of holders of unsecured Convertible Bonds, but on the pendency of additional reorganization legislation in Congress. There is no such legislation now pending following the veto thereof by the President.

The Debtor's petition for certiorari should be denied forthwith.

Dated, September 9, 1946.

Respectfully submitted,

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